

From the Editor

by Donn P. McVeigh, CPCU



members to respond. Please do not hesitate. We'll make room in a Letters to the Editor section in the next issue. If you do, please e-mail me at dmcveigh@worldnet.att.net.

For more information on the *Ingram Micro* case discussed in the computer viruses

This issue contains three very different articles. The computer viruses article is written by two policyholders attorneys and may engender some of our defense-oriented

article, please see the article titled "E-Coverage Alert," by John Leming, in the August 2000 issue of *Risk Management* magazine.

The final adjudication article was submitted to the Society by the author and should be helpful to all attorney members trying D&O coverage involving the Final adjudication exclusions.

The guide to a deposition article was written by an experienced percipient witness. To many attorney and expert witness members, this article may seem too fundamental, but the points discussed in this article are valid and worth your reading.

Let us hear from you and I hope to see many of you at the Annual Meeting in San Antonio. ■

Property Insurance Coverage for Computer Viruses

by Robert L. Carter Jr., Esq. and Donald O. Johnson, Esq.

Over the last few months, a variety of computer viruses have infected business and personal computers. The most publicized was the "Love Bug" computer virus, which swept through computers around the world, crippling e-mail communications and damaging select computer files. Some more recent viruses, like the Newlove.A virus, have had even more destructive potential, seeking to destroy word processing files, the lifeblood of big business.

These viruses have cost corporate America plenty. It is estimated that fighting the Love Bug cost businesses approximately \$10 billion. That estimate includes lost business, the cost of eliminating the virus from computer systems, and the cost of repairing, to the extent possible, damaged computer files.

Corporations cannot predict when the next destructive virus will be unleashed, but they know that it is only a matter of time. To protect against viruses, companies are examining the latest virus-detection technology. To protect against financial loss, com-

panies should examine their property insurance policies.

Property Insurance Protection

All-risk policies are the property insurance policies that most likely will cover cases of computer-virus-related loss or damage to computer programs or data, and cases of resultant business interruption. An all-risk policy provides coverage for physical loss or damage to insured property from all perils that the policy does not specifically exclude—meaning that all-risk policies cover unforeseen risks. All-risk policies typically contain a perils-insured clause that states: "This policy insures against all risks of direct physical loss or damage, except as excluded, to covered property. . . ."

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Property Insurance Coverage for Computer Viruses

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In *American Guarantee & Liability Insurance Co. v. Ingram Micro, Inc.*, No. 99-185 TUC ACM (D. Ariz. Apr. 19, 2000) (order granting defendant's motion for partial summary judgment) (*Ingram Micro*), a federal court recently held that "physical loss or damage" includes the destruction of computer programs and data. Although many insurance companies disagree with the *Ingram Micro* decision, many property insurance policies make its common sense reasoning clear with language stating: "Physical loss or damage shall include any destruction, distortion, or corruption of any computer data, coding, program, or software except as hereinafter excluded."

Covered Property—Computer Programs and Data

All property policies contain one or more clauses that identify the property the policy covers. A typical coverage clause provides that the policy insures the interest of the policyholder in: "[a]ll Real and Personal Property owned, used or intended for use by the insured, and property of others in the Insured's care, custody, or control. . . ."

Computer programs should be considered "personal property," and, as a result, should be covered property under a typical property policy. Because particular policies may vary from the norm, however, policyholders should examine their policies to determine whether computer programs have been excluded from the definition of covered property. Many property policies avoid any ambiguity in this area by specifically including electronic data-processing systems, including computer programs, in the definition of covered property.

Computer data also should be "personal property." Computer data, as well as computer programs, exist on computer hardware devices such as computer disks and tapes as a series of magnetic "on" and "off" switches. Those switches are the policyholder's property.

In addition to covering a policyholder's computer programs and data, these policies also may provide coverage for property belonging to a third party if that property is

in the policyholder's care, custody, or control. This coverage may be important to companies that are responsible for the computer programs or data of others, such as companies that provide systems management services or program and data storage services.

Common Exclusions Don't Apply to Virus-Induced Loss

Given the broad coverage provided by all-risk policies, the only instance in which virus-related loss or damage to computer programs and data would not appear to be covered would be those in which the policy specifically excludes coverage for computer programs and data, or for loss or damage caused by a computer virus. Absent those two exclusions, which many companies may seek to delete from their policies, other common exclusions should not apply.

The Y2K exclusions that insurance companies placed in many property insurance policies generally would not exclude coverage for computer-virus-related loss or damage, because such damage is not related to data processing. Similarly, typical design-defect, latent-defect, and error-in-machine programming exclusions do not apply to loss or damage caused by a computer virus. A virus is not a design defect or a latent defect in the policyholder's property; rather, it is an external element that a third party, without the policyholder's knowledge, has intentionally or unintentionally injected into the policyholder's computer system. Furthermore, a computer virus operates as designed; therefore, any resultant loss or damage is not caused by a design defect or programming error.

Many policies contain a "sue and labor" clause, which obligates the policyholder to take reasonable measures to protect covered property against loss or damage caused by covered perils. This clause also obligates the property insurer to reimburse the policyholder for expenses the policyholder incurs to prevent or to minimize such loss or damage.

If an all-risk property policy provides coverage for computer programs and data

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and does not exclude computer-virus-related loss or damage as a covered peril, a sue-and-labor clause will likely allow the policyholder to recover the expense that it incurs to prevent or to minimize computer-virus-related loss or damage. Courts construing typical sue-and-labor clauses have held that the amounts the insurer pays to the policyholder under the clause do not count against the policy's limit of liability and that the amounts claimed under the clause are not subject to the policy's deductible.

Many property insurance policies also include business interruption coverage and extra expense coverage, which, respectively, reimburse the policyholder for lost revenue

and the extra expense of restoring business operations. Because computer viruses have the potential to shut down computer-dependent businesses, such companies should carefully review their policies to determine the extent, if any, that they cover business-interruption and extra expense.

If a policyholder believes it may have a valid claim for computer-virus-related loss or damage, it should immediately notify its insurance carriers of its claim, because some insurance carriers may argue that, under some states' laws, untimely notice of claim forfeits a policyholder's claim. ■

D&O Policy “Final Adjudication” Exclusions Take On Growing Significance

by Carol A.N. Zacharias

Editor's note:

This article originally appeared in the CPCU Society's Claims Section Quarterly, Volume 18 No. 4.

Courts are divided on the amount and quality of the evidence that must be shown to win securities fraud cases against directors and officers. This is a very important debate, as it has direct impact on whether there is coverage under directors' and officers' liability policies. The following summarizes the prevailing albeit conflicting views and the impact on coverage.

Higher Standards of Proof

There are three standards applied by courts today:

1. Recklessness

Plaintiffs must show at least a circumstantial case of either:

- conscious misbehavior, or
- recklessness

This is the easiest threshold for plaintiffs to meet, because plaintiffs can opt for the second choice, proving mere recklessness, which is a much easier route than proving conscious misbehavior. *Press v. Chemical Investment Service Corp.*, 166 F.3d 529 (2d

Cir. 1999); *In re Advanta Securities Litigation*, 180 F.3d 525 (3d Cir. 1999).

2. Strong Inference of Recklessness

Plaintiffs must show a “strong inference” of recklessness. In re *Comshare Inc. Securities Litigation* 1999 WL 460917. This is more stringent, as mere recklessness will no longer suffice. There must be enough evidence to create a “strong inference” of recklessness.

3. Deliberate Recklessness

Plaintiffs must show “in great detail” facts showing “strong circumstantial evidence” of either:

- conscious misbehavior, or
- deliberate recklessness

In re *Silicon Graphics Inc. Securities Litigation*, 1999 WL 446521. This is the most difficult standard for the plaintiffs, as they have to prove “recklessness-plus,” that is, recklessness coupled with evidence and

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D&O Policy “Final Adjudication” Exclusions Take On Growing Significance

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circumstances that show that the reckless activities were actually deliberate. This may be hard to do, depending on the facts.

Impact on D&O Coverage

Most D&O policies exclude dishonesty, fraud, and personal profiting. The tougher the pleadings, the closer the facts come to allegations of dishonesty, fraud, or profit. For example, if mere recklessness is shown, there may be no evidence of dishonesty. But if deliberateness must be shown, that may include proof of a deliberately fraudulent and dishonest act, which triggers the exclusions. Hence, litigation must be watched closely to see which course it takes.

Some policies apply the dishonesty, fraud, and profit exclusions whenever the acts are established “in fact.” Some members of the D&O insurance industry specu-

late that these acts are factually established when documents are adduced in discovery. Thus, for example, if pink trading slips show short swing profits, that is excluded illegal personal profit, and the slips establish it “in fact.” This may be undesirable policy language in that coverage may be denied at any point in the litigation, depending on what discovery turns up.

Not all policies have the “in fact” language. Some, like CNA Pro’s Select Solutions forms, provide broader coverage by applying the dishonesty, fraud, and profit exclusions only if, and when, there is a final adjudication of the dishonesty, fraud, and profit. Thus, the exclusions would not apply to defense costs and would not apply to any settlement. This type of policy can be very helpful to directors and officers given the increasing level of allegations needed to maintain an action. ■

Editor’s note:

This article should not be construed as legal advice or a legal opinion on any factual situation. Its contents are intended for general information purposes only. As legal advice must be tailored to the specific circumstance of each case, the general information provided herein is not intended to substitute for the advice of professional counsel.

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Zacharias has written for a securities regulation textbook and in a variety of periodicals such as The Bank Director, The John Liner Review, and others. She is a frequent speaker in North America and abroad and has taught professional liability at New York’s College of Insurance. She can be reached at CNA Pro, 40 Wall Street, 9th Floor, New York, NY 10005-2301; telephone: (212) 440-7806; facsimile: (212) 440-3699; e-mail: Carol.zacharias@cna.com.

A Guide to Being Deposed

by Earl D. Kersting, CPCU

Editor's note:

This article originally appeared in the CPCU Society's Claims Section Quarterly, Volume 18 No. 4.

Earl D. Kersting, CPCU, ALCM, ARM, AAI, AIC, is the Safety, Health and Claims Manager for the Kroger Co., Delta Division, a position he has held since 1986. He earned his bachelor's degree in risk management and insurance with honors from Ohio University, and has worked at Kroger since 1974, his first and only employer. Kersting has recently been appointed to the CPCU Society's Risk Management Section Committee.

Claims personnel are often noticed for depositions. If you have never been the subject (meaning victim) of a deposition it can be a nerve-racking experience filled with uneasy anticipation. However, much of the anxiety can be eliminated if you simply know in advance what to expect, and then prepare for it.



A deposition is a legal proceeding designed to preserve the testimony of a witness for later use in a courtroom, or to prevent the testimony from later changing in the courtroom. It is conducted in the presence of your company's attorney, the plaintiff's attorney, and a court reporter who records your testimony. The court reporter swears you in under oath, and then the plaintiff's attorney asks you a series of questions with your company attorney monitoring the process so that only proper and allowable questions are answered.

Why a Deposition?

Lawyers take depositions to discover before trial what a witness's testimony will be so that they can prepare a defense around it, and so it won't change and embarrass them in the courtroom in front of the jury. The following is a brief list of just some of what the plaintiff's attorney is seeking to accomplish with your deposition:

- to discover exactly what you know about the issue at hand
- to find evidence favorable to their client's case
- to commit you to statements under oath so that you can't change them later

- to find information that they can use in a courtroom to discredit your testimony
- to discover what your company's defenses are to allow them to prepare a counter-defense
- to preserve testimony in case a witness dies or becomes unlocatable

What Are Your Duties During a Deposition?

Very simply, your duties are to:

- tell the truth
- avoid exaggeration and only answer what is asked
- be accurate in your responses

However, the opposing attorney may make it very difficult to accomplish these goals, so here are some tips for dealing with opposing counsel.

Tips for Dealing with Opposing Counsel

- Never lose sight of the purpose of your deposition. The claimant's attorney is out to strengthen his client's case and look for weaknesses in your company's case.
- **Never** volunteer additional information. If the question can be answered "yes" or "no," do so! For example, if the question is asked does a "_____ manual exist, and one doesn't, don't answer "No, but a _____ manual exists." Simply answer "no."
- Make sure that you understand the question in its entirety. If it is a complicated or a compound question never hesitate to ask the attorney to repeat it, or to break it down into subparts.
- Listen to the **entire** question; consider it very carefully; think about how you want to phrase your answer; and **then** carefully answer in the words you feel best convey exactly what you wish to say.
- **Never guess.** You won't look stupid saying "I don't know." You will look stupid later on if you guess at an answer and you guessed wrong.

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- By the same token, if you simply don't remember the answer, say "I don't remember."
- Be patient. Sometimes opposing counsel may drag out your deposition in hopes of tiring you out or wearing you down so that you'll say something you normally would not. If you need a break don't hesitate to ask for one, or simply ask to go to the restroom.
- Don't ever lose your temper. The plaintiff's attorney would love to be able to portray you as uncooperative or hostile.
- Always be polite, yet firm in your answer. Answer precisely, not with generalizations.
- Speak clearly. Answer "yes" or "no," not "uh-huh," "duh," etc.
- Always finish your answer. A deposition is more informal than courtroom testimony. Opposing counsel may try to cut you off before you get a chance to explain your answer, but simply turn to your company's attorney and ask that he allow you to fully explain your answer in cross-examination.
- Correct any inaccurate answers. If you realize that an answer you previously gave was inaccurate or incomplete, go back and correct it on the record.
- When handed documents as evidence read them very thoroughly and in their entirety before you answer questions regarding them.
- Never answer questions regarding any document with which you are not thoroughly familiar.
- Read the document in its entirety, and then ask to keep it in front of you as a reference while you are questioned about it.
- If opposing counsel implies that a certain document suggests a certain fact, read it and make sure that it really does before agreeing that it does.
- Insist that you be provided a complete copy of the document, not just excerpts.
- Take your time in reading the document. Don't allow opposing counsel to pressure you to just browse the document. Read until you are comfortable that you know its contents.
- Don't fall victim to the attorney's style. He is a good actor and well-versed in

tactics to intimidate you into becoming unnerved or disarmed.

- Never take anything into the deposition other than what is required, and nothing that your company attorney is not aware of and has not reviewed. Any additional file material, manuals, or documents will just become a source of additional questions.
- Never make an assumption, and never answer hypothetical "what if" questions. If it isn't what happened, answer "I can't say what if, because that isn't what took place."
- Don't be afraid to be afraid. Realize up front that opposing counsel will try to shake you and will try to make you look like you don't know what you are talking about. Knowing in advance that this is one of his tactics will help you to anticipate it. Only answer what you know to be true.

Watch Out for Trick Questions and Attorney Tactics



Again, realize right up front that the opposing counsel will try to make you appear to know less than you really do. Be prepared for the following tactics:

- An attorney may intentionally state inaccurate dates or times to try to confuse you and get you to admit to inaccurate facts. If you need to review the records to be sure, ask to do so.
- Be aware of self-serving statements made to sound like questions, such as "Now you knew this could be a dangerous location, didn't you?"



- Be aware of questions designed to play on vanity, such as “With all your education and experience, surely you knew . . .”
- Be aware of summarizations that attempt to misquote you, such as “So then what you’re saying is . . .”
- When opposing counsel is attempting to get you to answer a question of generalization, answer with a specific response. If the question is “So it was longer than usual since the area was inspected,” the answer should be “It was ____ minutes.”
- Watch for trick questions, such as “So even though my client fell there, to this day you do nothing different in that area?”
- Watch for questions that imply you should have or could have done things differently, such as “If you had ____ , this wouldn’t have happened, would it?” (You didn’t do it, so don’t guess about how things that never occurred may have changed matters.)
- Watch for the “possible” or “impossible” question, such as “Is it possible that . . .” or “Is it impossible that . . .” Simply answer, “I don’t know for certain and therefore cannot answer.”
- Watch for the “To the best of your knowledge” questions. Again, if you don’t know for certain, simply answer, “I don’t know for certain and therefore cannot answer.”

- Watch out for questions worded in a manner to confuse you, such as double negatives, in which you don’t know if you should answer yes or no. Ask that the question be rephrased.
- Watch out for overly broad questions that may appear to be true on the surface, but may be so broad as to include “traps.” An example may be, “Would you not agree that it is the manager’s duty to provide a safe environment, and that as a part of that duty the premises should be inspected frequently, and as part of that inspection you should check the floors, and that if something was in fact on the floor it should have been seen during your inspection, and therefore you should have been aware of the liquid on which my client fell?”
- And really watch out for the “silent treatment.” Many times opposing counsel will simply remain silent after your answer, hoping that you’ll feel uncomfortable and feel that you must not have provided enough information. More information is exactly what he is looking for, but don’t provide any more than exactly what was asked for.

This is certainly not an exhaustive manual that answers every question that could be raised regarding a deposition, but is designed strictly as a guide to help you understand what to expect and how to prepare for it. I hope that you find it to be of use to help you enter your deposition more calmly and without unnecessary fear. Above all, always remember the number one rule of any deposition: answer what you know to be true and nothing else. ■

Join us in San Antonio!

October 22-24, 2000

The CPCU Society's 56th Annual Meeting and Seminars features an outstanding slate of educational seminars.

The following seminar, which will be held on Tuesday, October 24, is sponsored by the Consulting, Litigation, & Expert Witness Section.

Employment Practices Liability on Trial

Will you be chosen as a juror for a thought-provoking and entertaining mock trial that highlights employment practices liability coverage, including bad faith allegations? In voir dire, the trial judge and counsel will discuss the impact of the recent Supreme Court decision affecting the qualification and disqualification of expert witnesses. Anyone involved in coverage litigation can't afford to miss this cutting-edge and informative seminar. *Filed for 3 CE credits.*



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Consulting,
Litigation, &
Expert Witness
Section
Quarterly

Vol. 7 No. 3
October 2000

CLEW Section Quarterly

is published four times a year by and for the members of the Society's Consulting, Litigation, & Expert Witness Section.

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